EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF SCIENCE AND TECHNOLOGY POLICY
WASHINGTON, D.C. 20500

Executive Registry
77-10421

Nov 29, 1977

TO: Admiral Stan Turner

FROM: [redacted]

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HARVARD

RRC NEWSLETTER

RUSSIAN RESEARCH CENTER

Vol. [illegible] No. 2 October 6, 1977

INDUSTRIAL PRODUCTION FOR THE FIRST EIGHT MONTHS OF 1977

Product	Jan-Aug	% of Jan-Aug 76
Electricity [bil. kw. hours]	747.0	103.0
Petroleum (Including gas condensate) [mil. tons]	361.0	105.0
Natural gas [bil. cu. m.]	226.0	108.0
Coal [mil. tons]	481.0	102.0
Steel [mil. tons]	97.7	100.8
Fertilizer [mil. tons]	64.0	105.0
Metal-cutting Tools [1000's]	152.0	103.0
Computer Technology [bil. rubs.]	1.8	124.0
Watches [mils.]	40.3	106.0
Radios [mils.]	5643.0	102.0
Televisions [1000's]	4679.0	99.0
Paper [mil. tons]	3.6	102.0
Cement [mil. tons]	84.7	102.0
Meat [mil. tons]	5.1	112.0
Vegetable oil production [mil. tons]	1566.0	106.0
Motor Vehicles [1000's]	1377.0	103.0
cars [1000's]	847.0	103.0
trucks [1000's]	482.0	103.0
Tractors [1000's]	377.0	101.0

The CIA has released a series of reports on the Soviet Union that are of interest beyond the narrow circle of Soviet specialists. Since the CIA has been studying and releasing reports on the Soviet Union for many years, this normally would not be worth commenting upon. What makes the situation different now, however, is that some of their reports have become quite controversial largely because they impinge beyond the economic development of the Soviet Union itself. In particular its report on petroleum served as one of the key elements in the analysis used by President Carter in setting forth his energy message a few months ago. Based on the very dire predictions of the CIA as regards the Soviet Union, the implication was that the United States, and for that matter, the world, would have an oil crisis, if possible, even more serious than it appears to be now.

The main cause for concern viewed by the CIA was that instead of being a net exporter outside the Communist countries of a million barrel a day, by 1985, the Soviet Union would be importing 3 1/2 to 4 1/2 million barrels a day. That is equivalent to Saudi Arabia's current total production. Obviously, if the Soviet Union should enter into the world market for such large quantities, there would be a very serious question of whether or not such quantities of petroleum could be provided. In other words, from the actions of the Soviet Union and Eastern Europe alone, there would be a net swing in demand of approximately 4 1/2 to 5 1/2 million barrels a day as the Soviet Union ceases to export and instead begins to import.

The CIA position was sharply attacked by a variety of critics, including this editor (see the May issue of this Newsletter). It was not so much that the CIA's research was at fault. indeed their research showing domestic production problems was impressive. What was at fault was their economic analysis following from this research. Based on their research, the CIA analysts found that the Soviet Union was having great difficulty in

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maintaining the production of wells in older fields. Moreover, there were difficulties in even some of the newer fields, because the Soviets were injecting so much water into the oil wells in order to maintain pressure. This was done as a short-run expedient to increase oil output. The implication for the long run, however, was that the Soviets would have to pump twice as hard to extract the amount of petroleum they would like to extract because they would have to take out increasing quantities of water that had been pumped in earlier. Moreover, the Soviets were not increasing their exploration for new fields as rapidly as they should. Given the existing increase in demand for energy and given the projections of the fall-off in output from existing wells, it seemed logical to conclude that there would be a short fall between demand and supply in the Soviet Union and in Eastern Europe. The only way this short fall could be handled, the CIA argued, would be to import petroleum.

The main difficulties with this conclusion was that no matter what the domestic problems might indeed be, there was no way the Soviets could afford to pay for so much petroleum. To pay for such imports would cost the Soviet Union between $15 and $20 billion at current prices. However, the actual sum would probably be much more in real terms if the Soviet Union seriously embarked onto the world market as a purchaser of such large quantities. Given the fact that total Soviet export earnings in 1976 amounted to somewhat less than $9 billion, it is hard to see how the Soviet Union could afford such vast sums of money. That would assume first of all that they stopped all other forms of import and most importantly, did not have to rely on imports for any shortages of grain ever again. Moreover, since petroleum exports presently earn them almost half of their total hard currency earnings, they would not even have that $9 billion to work with. Consequently, unless there was to be some military take-over of the Middle East producers, there seems to be no way in which the Soviets could obtain such large quantities. In their best years, the most the Soviets have been able to obtain from one country in the Middle East was in 1973 from Iraq, when they imported slightly more than 10 million tons of petroleum. In recent years the figures have been half of that. Thus, no matter what Soviet needs might be, they would not have the wherewithall to pay for it.

In addition the CIA seemed to underrate the Soviet ability to obtain Western technology to help them out. The CIA asserted that the demand for oil technology in the West was already too high and, therefore, American and other Western suppliers would be unable to fill Soviet demands. That seems to be a poor assessment of the situation, since indeed American corporations have been actively seeking to win Soviet orders. Many of them now have considerable capacity to meet Soviet demands should they be forthcoming. Moreover, the Soviets have barely begun to explore in new areas of East Siberia and at different geological strata in West Siberia. Furthermore, they have just begun to buy Western equipment for the exploration of offshore fields in the Caspian, Black, and Arctic Seas. Finally, in a marked departure from past practices, the Soviets have entered into joint ventures with Japanese and American companies to explore for petroleum off the shores of Sakhalin and for natural gas in the Yakutia region. All this indicates that not only can the Soviet Union utilize Western technology to increase its production, but it also has many potential areas of development that the CIA seems to have underrated. It is true that not all of these areas can be brought into play at a moment's notice, but the Soviets have indeed begun to expand their offshore capability and are as well exploring other fields on shore.

The Soviets, of course, need not depend entirely on petroleum for domestic use. They have some of the world's largest reserves of natural gas and coal. In particular, the natural gas seems well suited for use as a substitute for petroleum. If nothing else, the Soviets can set aside their petroleum for export and substitute other fuels instead. The flexibility is not enormous, but there is enough to satisfy the immediate problem.

Many of the above arguments were made and some of them apparently did have some effect with the CIA analysts. There still seems to be a very strong group of CIA specialists who feel that the Soviet Union will have to import the originally specified quantities. However, the CIA does seem to have taken into consideration some of the above criticism, and as a result there has been some reconsideration. Not much attention has been called to it, certainly not by President Carter's office, but in the CIA analysis of July, 1977

entitled "Soviet Economic Problems and Prospects," the CIA does lower its estimates of Soviet import needs. On p. 22 of that study, the report states that the Soviet Union will have to import 2.7 million barrels a day by 1985. That is approximately 1 to 2 million barrels a day less than they had originally expected. In a footnote on that page, the CIA explains in more detail this reduced estimate. Although their reduced estimates still seems too high, they tend to explain away the difference by suggesting that the earlier estimates included the import needs for Rumania and Yugoslavia. That would imply that Rumania and Yugoslavia imported approximately 50 to 100 million tons a year. That is an extreme exaggeration, and hardly can be expected to account for the whole difference in their estimates. In other words, the CIA apparently has recognized the economic implications of what they suggested earlier and now have cut back their estimate sharply. Their explanation for the cutback is a rather embarrassing one and certainly not satisfactory. The CIA suggests that, if Rumania and Yugoslavia are included, the Soviet Union will still have to import 3.9 million barrels a day. That hardly seems likely.

Finally, it should be pointed out that to some extent the CIA's report as much as anything can help to ensure that the Soviet Union does not have to import as much as the CIA expected. The very fact that the CIA report appeared tends to make it a non-fulfilling prophecy. Given the seriousness of the CIA forecast, officials in the Ministry of Petroleum Industry can approach the officials in the Ministry of Foreign Trade and argue as never before that they must have more support in obtaining hard currency in order to buy the petroleum producing equipment and technology available in the West. The CIA report should provide them with the clout they may have been missing. As a result, their bargaining stance has increased immensely, and this should make it possible for them to avoid the dire forecasts indicated by the CIA.

Although this is purely a personal opinion, one cannot help but feel the CIA has made a mistake in the way it has handled this study of the Soviet petroleum industry. In the first place it did not adequately reflect the economic implications of a very good technical analysis. Secondly, when it did make this information available to the President, the implications of what it was doing went far beyond a purely internal analysis. Finally, the CIA owes the President and the country a more prominent acknowledgement of its changed estimate than it has so far provided. It is never easy to acknowledge that one has made a mistake in one's analysis, but given the importance of this particular study, there should have been some more public retraction.

Marshall I. Goldman

CURRENCY EXCHANGE*

Per 100	Jan. 3	July 20	Sept. 5
Aust. s.	4.430	4.480	4.450
U.K. pound	125.000	126.000	128.000
W. Ger.mark	31.340	31.650	31.610
Can.dollar	73.290	69.450	68.290
U.S.dollar	74.200	73.400	73.400
Fr. franc	15.000	15.070	14.940
Jap. yen	.253	.278	.275
Ital.lira	.086	.083	.083
Swiss franc	30.400	30.150	30.700

The value of the British pound and Swiss franc rose in August. The U.S. dollar and Italian lira remained constant, while the Austrian shilling, West German mark, Canadian dollar, French franc, and Japanese yen all declined.

* New currency figures were unavailable before publication, thus figures from Vol. II, No. 1 are reproduced here.